

Executive **Summary.**

Evaluating Tier 1 Banks: The Making of the Class of 2024.

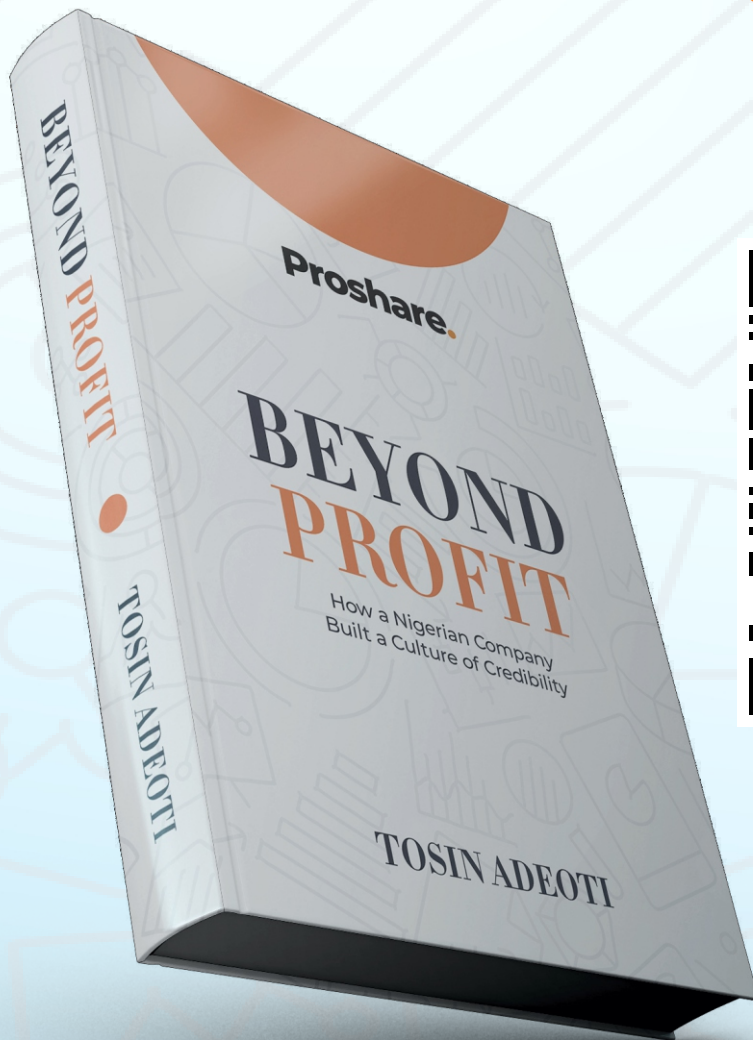


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What the **Report** Covered.

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Executive Summary.

Recapitalising Tier 1 Banks: The Consequences of Getting Bigger, Faster.

Banks are like bulls in a pen; they are stuck behind bars that are difficult to escape. Banking, on the other hand, is free-spirited, agile, and capable of reinterpreting economic reality. Over the last two decades, the financial payment and settlement business has increasingly grown on the back of cloud-based blockchain technology, which may be destined to improve the efficiency of financial transactions and the quality of person-to-person (P2P) and business-to-business (B2B) relationships.

In reviewing bank performances in 2023, Proshare analysts observed that banks were pursuing increasingly aggressive approaches to acquiring digital market share while supporting lower operating costs (lower cost-to-income ratios (CIRs)). This has shown up in Proshare's analyst's Bank Strength Index (PBSI), where Access Corp ranked highest amongst its tier 1 counterparts, but GTCO fell a few notches because of relative weakness in key indicators such as asset size and growth (see table 1).

Table 1

2023/2024 PBSI RANKING				
		Score	Percentile Rank	Tier
	ACCESS CORP	7.28	100%	1
	ZENITH	6.84	91%	
	FBNH	6.32	82%	
	ETI	5.96	73%	
	UBA	4.22	64%	
	GTCO	3.37	55%	
	FIDELITY	2.90	45%	2
	FCMB	2.63	36%	
	STANBIC IBTC	2.49	27%	
	STERLING HOLDCO	1.05	18%	
	WEMA	0.49	9%	
	UNITY (9M)	0.38	0%	

Source: Proshare Research

Proshare's PBSI reflects the shifting concerns around lower cost-to-income ratios (CIRs), lower cost of risk (CoR), and lower nonperforming loan ratios (NPLRs). In this regard, analysts believe that banking sector transactions will increasingly become a matter of a few keystrokes on mobile devices as

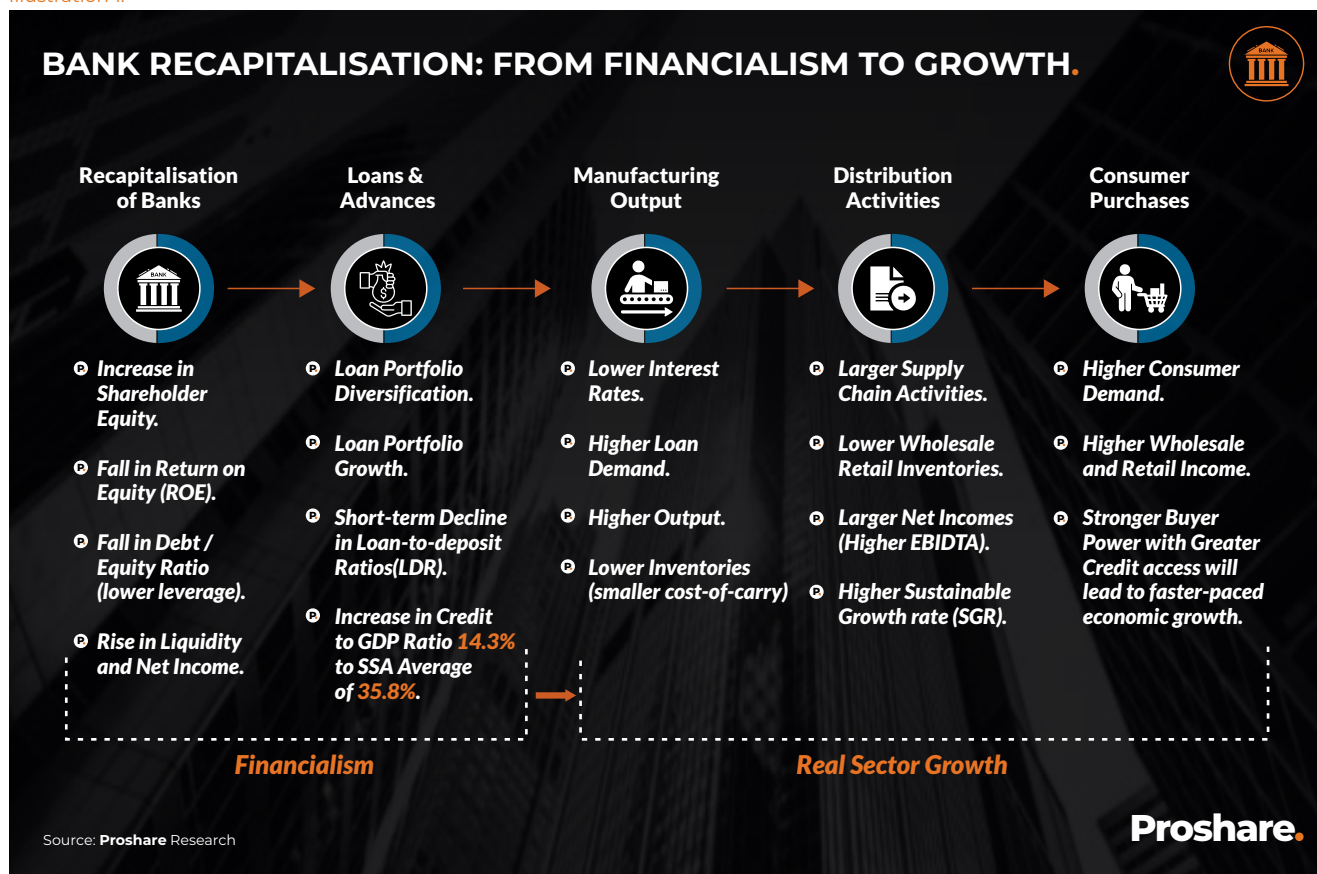


consumer experiences turn sharp corners towards speed, precision, and satisfaction. In a conversation with Segun Atere, Head of Corporate Finance at Apel Assets and Trust Group, he noted that *“The banking skyline will not disappear any time soon, but the architectural splendour of glass towers, quadrangular courtyards, and sleek furnishing will yield to quiet but efficient digital services, lightning-fast problem solving, and the beauty of being a productive couch potato doing business in the comfort of a lovely living room.”*

With an ongoing Central Bank of Nigeria (CBN)-inspired banking sector recapitalisation programme, investment in financial technology, customer service scalability, and digital asset engineering will take a fresh turn between 2024 and 2026. The financial service landscape will look astonishingly different in the months ahead. According to Atere *‘digitisation will be the great disruptor with business analytics and artificial intelligence (AI) separating corporate highflyers from laggards. However, business leaders will need more than gizmos; they will need an understanding of consumers, a feel for numbers, and a clever eye for the next business curved ball’*. A few corporate strategists believe that Nigeria’s deposit money institutions (DMBs) may do one or a few of the following:

- Ⓢ Increase investment in blockchain technologies.
- Ⓢ Deepen Artificial Intelligence/Machine Learning applications.
- Ⓢ Improve back-office processing automation.
- Ⓢ Move credit appraisal and approval to cloud-based applications for smaller loan thresholds.
- Ⓢ Shift principal customer interface to web-based service experiences.
- Ⓢ Redefine customer experiences to reduce cost, increase value, and limit risk (see illustration 1).

Illustration 1:





The strategic verticals will involve:

- ④ Technology improvements/database management
- ④ Customer analytics.
- ④ Human resource realignments.
- ④ Environmental scanning.
- ④ Nowcasting.
- ④ Service/Product design and redesign.

With higher capital levels, banks must use the larger amounts of cash available to improve shareholder returns and customer service experiences. Many banks will get cut at the knees by lacking a deliberate strategy to transition from cash flow to value creation. Recalling the challenges faced by banks during the Charles Soludo-inspired recapitalisation in 2005, a few bank executives would have more money than business skills, resulting in a terrible waste of additional capital.

While bank recapitalisation may be considered useful, it can be a death trap for the uninitiated and ill-prepared. An economy in a hurry depends not only on money but also on leadership. According to an in-house Proshare analyst, 'In my experience, Institutional size may be necessary for corporate growth, but it is not a sufficient condition for success. Several corporate *Goliaths* have been brought to their knees by business *Davids* because the tools of warfare and the battle conditions require speed, skill, and purpose and not brawn, girth, and armour represented by the size of their corporate war chest'.

The American New Yorker columnist and award-winning author Malcolm Gladwell noted in his best-selling book '**David and Goliath: Underdogs, Misfits, and the Art of Battling Giants**', that '*Courage is not something that you already have that makes you brave when tough times start. Courage is what you earn when you've been through the tough times, and you discover they aren't so tough after all.*' Does this mean that telling Nigerian banks to grow bigger in two years is courageous? Certainly. Nigerian banks must grow bigger regardless of the federal government's aspiration to grow the country's gross domestic product (GDP) to US\$1bn by 2030. The matter is less about Nigeria's GDP and more about its financial stability and capacity.

Indeed, apart from banks having resources to give larger loans to companies and individuals, raising the size of banks' equity capital would enable them to:

- ④ Build public, individual and institutional confidence in their stability and systemic durability. Scale back loan asset of a few banks who were in regulatory forbearance with the CBN, meaning the regulator allowed these banks some leeway concerning loan asset status, liquidity, and provisions.
- ④ Improve domestic deposit money banks (DMBs) credit ratings, thereby reducing their costs of borrowing.
- ④ Move towards improving common equity tier 1 (CET1) capital and edging towards Basle III compliance.
- ④ Reassess retained earnings (believed to have been the reason for the CBN's insistence on bank recapitalisation using (CET1) capital devoid of retained earnings in favour of fresh equity and share premiums.
- ④ Improve research and development to nudge further improvements in customer service experiences.
Improve human capital through global best standards professional training.



However, these points are not without problems. Raising larger bank capital would generally appear good, but whether this improves a bank's or any other company's fortunes depend on how the additional capital is used. Giving a tailor more hammers does not solve his or her sewing problems. In the months ahead, it will be important for the CBN to monitor how the additional CET1 capital of banks is utilised. An example would probably make things clearer. A review of former CBN Governor Dr Chukwuma Soludo's recapitalisation effort in 2005 sheds light on what could go wrong. Banks that could not manage a capital base of N2bn were suddenly saddled with the responsibility of managing a N25bn capital base; the outcome was mixed and, in one or two instances, disastrous.

One bank with a strong family equity interest went on an insider-related spending spree. Depositors' funds were used to fund various family-related businesses, ranging from real estate to oil and gas, airline, and warehousing. The exposure to these businesses was in breach of the bank's single-obligor limit, but more importantly, the repayment cash flows were unsupported by the tenors of customer deposits, creating an asset and liability gap that caused the bank to become a regular interbank taker rather than placer of funds.

The liquidity challenge caused by poor asset and liability management (ALM) was compounded by poor-quality loans and advances. In 2010, the recently reinstated Emir of Kano, Muhammad Sanusi II-led CBN, had to take measures to protect the bank from causing a systemic challenge by placing it under the newly created asset management company of Nigeria (AMCON), which later sold the financial lending institution to Ecobank Transnational Incorporated (ETI). Muhammad Sanusi II, a former Central Bank of Nigeria (CBN) Governor, pointed out that a few banks at the time showed signs of financial strain that could potentially harm the overall banking system.

In his book **'The Rage of the Risk God,'** and quoting then CBN Governor, Dr Chukuma Soludo, financial journalist Dr Ray Echebiri noted that, *"As at the end-June 2024, 89 deposit money banks were operating in the country, comprising institutions of various sizes and degrees of soundness. Structurally, the sector is highly concentrated, as the ten largest banks account for about 50 per cent of the industry's total assets/liabilities. Most banks in Nigeria have a capitalisation of less than US\$10m. Even the largest bank in Nigeria has a capital base of about US\$240m compared to US\$526m for the smallest bank in Malaysia."*

Soludo further observed that *"The small size of most of our banks. Each with expensive headquarters, separate investment in software and hardware, high fixed costs and operating expenses, and with bunching of branches in few commercial centres, lead to a very high average cost for the industry."* The consequence was a higher cost of intermediation and higher spreads between lending and deposit rates, leading to banks being tempted to cut operating and prudential corners.

In the unfolding era post-Soludo and his successor Khalifa Muhammad Sanusi II, banking has gradually shifted from brick-and-mortar assignment of 'places' for commercial activities to digital notions of 'spaces' for transactional settlements or initiation. Core operating costs as a proportion of incomes have fallen. Some observers have noted that while banks may become an increasingly extinct breed of corporate animals, banking will survive and thrive in the digital jungle of ideas and commercial value creation. One major lesson learned over the decades is that a bank's size and sustainability are different propositions. While size is beautiful, it does not define success.



Table 2:

RECENT RECAPITALISATION EXERCISES IN CONTEXT.



	1997	2001/2002	2005	2023/2024
CBN GOVERNOR	Paul Agbai Ogwuma	Joseph Oladele Sanusi	Charles Chukwuma Soludo	Olayemi Cardoso
Purpose	To strengthen the banking system for effective monetary policy management	To reduce the number of distressed banks and support the universal banking	To address weak capital base and over-dependency on public sector deposits	To ensure the emergence of stronger, healthier and more resilient banks in line with the projected US\$1trn economy.
Exchange Rate (N/US\$)	21.88	111.23	131.27	1,338.60
REAL GDP Value (N'bn)	23,469.34	26,935.32	38,777.01	77,936.10
Inflation Rate	8.53%	18.87%	17.86%	31.60%
Capital Adjustment	Commercial banks: 50m → 500m	Commercial banks: 500m → 2bn	Comm: International 2bn → 50bn	Comm: International 50bn → 500bn
	Merchant banks: 40m → 500m	Merchant banks: 500m → 2bn	Comm: National 2bn → 25bn	Comm: National 25bn → 200bn
			Comm: Regional 2bn → 10bn	Comm: Regional 10bn → 50bn
			Merchant: National 2bn → 15bn	Merchant: National 15bn → 50bn

Source: CBN, NBS, Proshare Research

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Bankers increasingly understand that success requires clarity of vision, strength of purpose, and consistent dedication to a smooth project, programme, and process. Analysts have argued that banks require customer sensitivity, digital dexterity, and corporate flexibility beyond capital. Financial observers believe that these characteristics will separate corporate winners from losers. The transition of Nigeria's banking sector and the evolution of its banks will depend on digital innovations and an understanding of customers' experience journeys and expectations and how to meet them. This would involve increasingly flat organisational structures and corporate agility.

Section 1 introduces the report by delving into the global context of banking regulations and capital adequacy, focusing on the benchmark BIS Basel Accords. The section also calibrates top-tier banks within the broader African banking landscape. Comparisons are made regarding capitalisation, asset sizes, and earnings to provide context and benchmark performance. Nigerian banks' capitalisation is situated relative to their African counterparts, which could highlight their ability to raise capital and finance big-ticket transactions. The section ends with a snapshot of bank size vis-à-vis the size of the economy, a key consideration in maintaining stability and fostering the economy's growth.

Section 2 evaluates Nigerian banks based on performance and value metrics, offering a comprehensive ranking system across the PBSI metrics. Capitalisation metrics such as share capital and share premium are analysed to gauge financial robustness. Assets features are examined through asset sizes, loan assets, asset growth, and the Non-Performing Loans Ratio (NPLR). Banks' risk profiles are also ranked in the session using the Capital Adequacy Ratio (CAR) and Cost of Risk (CoR). Efficiency and profitability metrics provide insight into the operational prudence of banks, including earning growth, Cost to Income Ratio (CIR), and Net Interest Margin (NIM). Additionally, the degree of digitalisation is measured by the proportion of e-banking to gross earnings, while governance is evaluated and ranked through the proportion of Independent Non-Executive Directors (INED) and gender diversity on boards.

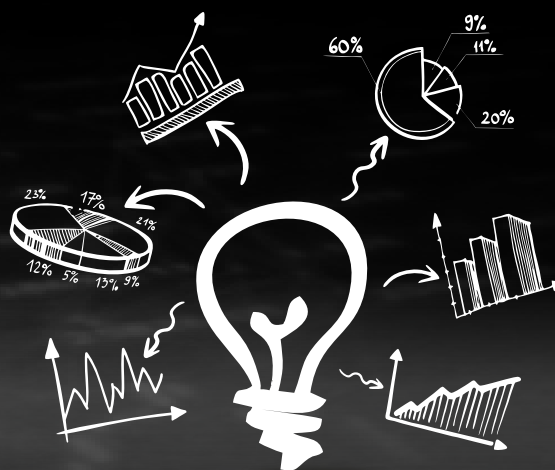


Section 3 presents the Tier 1 banks in 2023. This begins with a review of the FY 2022 and the pre-emptive H1 2023 performance. The section standardises the methodology for classifying Tier 1 banks, ensuring consistency and comparability. The new class of Tier 1 banks with FY 2023 results is presented herein, highlighting key players and shifts within the tier. This section further examines the regulatory calibration of banks to underscore how regulators are maintaining/adjusting requirements to maintain stability and encourage growth. The final subsection discuss the implications of top-tier banks for the banking industry.

Section 4 describes the nuances and complexities surrounding the CBN-ordered recapitalisation of banks, particularly the necessities or otherwise, the paid-up capital, share premium, and retained earnings debates in the recapitalisation exercise. The consequences of banks being either too big or too small are explored, specifically in relation to systemic risks and the size of the economy. The section ends with an outlook on tier 1 banks regarding their recapitalisation, digital trends, and risk management, which are likely to define the future tier 1 ranking of these banks.

The concluding **section 5** synthesises the findings from the previous sections, offering strategic recommendations for banking operators and regulators. Key insights into the nuances of recapitalisation, performance metrics, and the comparative analysis of Nigerian and African banks are contextualised with spot-on recommendations to boost banking operations, enhance regulatory frameworks, improve governance standards, and foster digital transformation within the Nigerian banking system.





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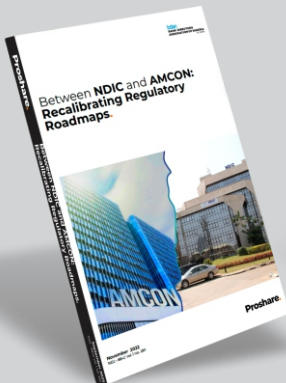
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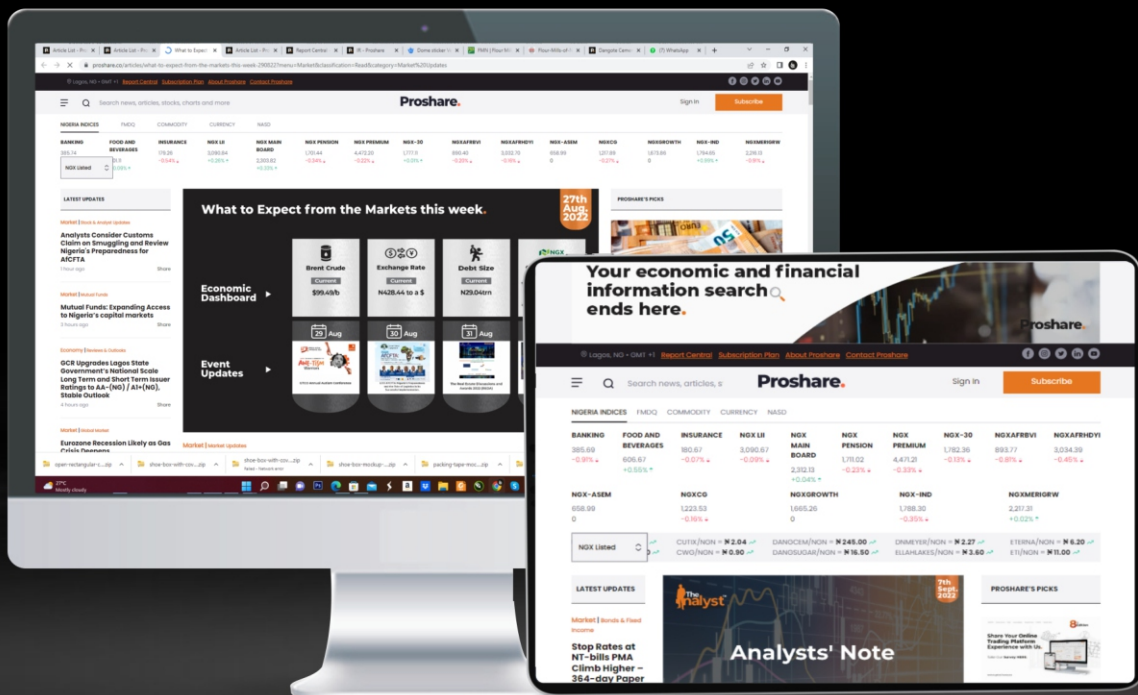
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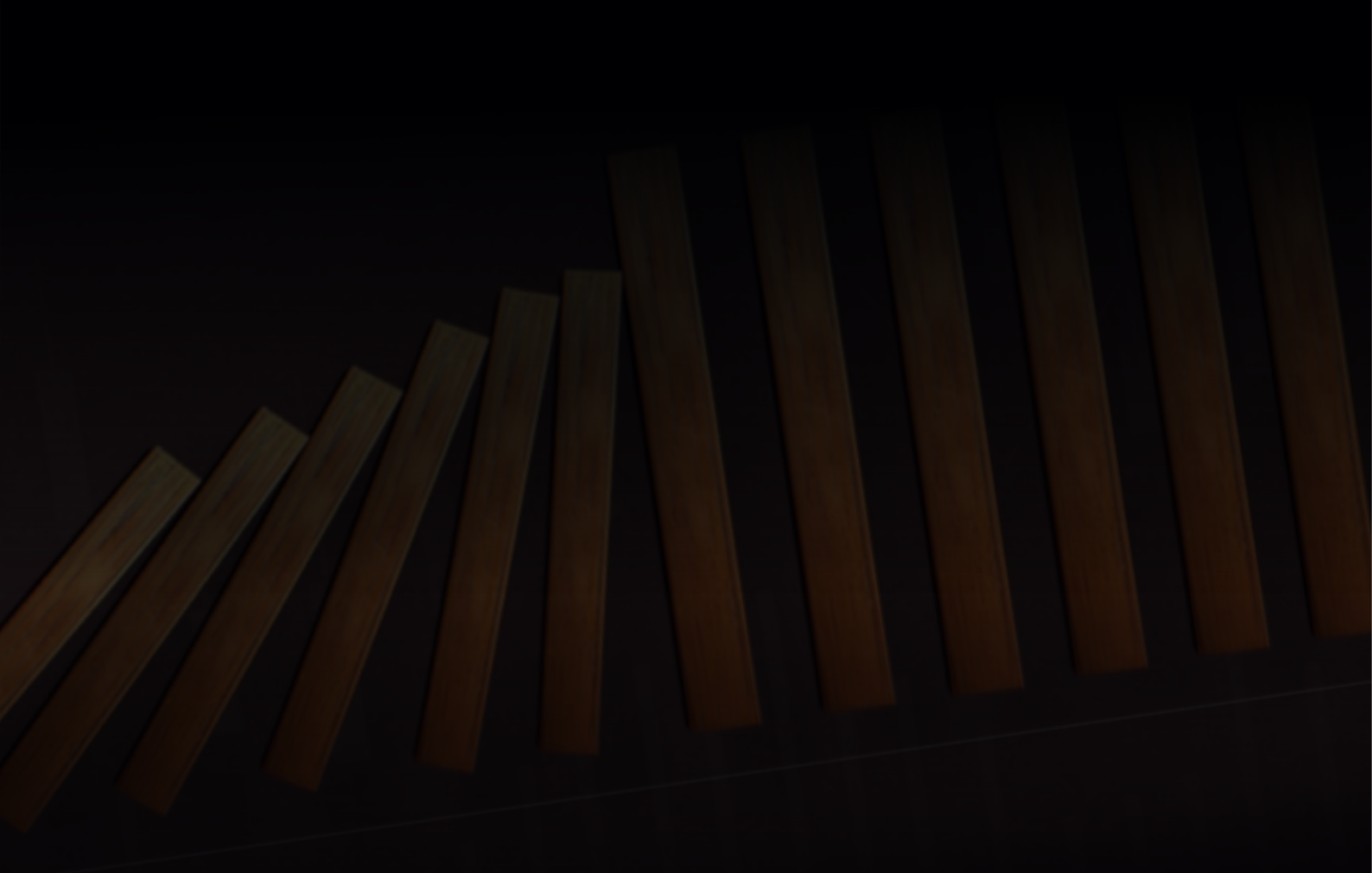
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